THE BOND BUYER
THE DAILY NEWSPAPER OF PUBLIC FINANCE

California Breathes Deep

Reduced Ran Deal Sells With Lower Yields

Bond Buyer | Friday, October 17, 2008

By Andrew Ward

SAN FRANCISCO - California successfully issued $5 billion of notes this week in the midst of the deepest financial crisis since the Great Depression. The state's local governments issued a big sigh of relief.

The revenue anticipation note sale shows governments can access credit if they're willing to offer enough yield to entice individual investors. That's good news for California municipalities that have pulled or delayed at least $600 million of bond deals in the past month.

"You can raise capital," said Jeffrey Small, a managing director at the Capital Public Finance Group in Sacramento and a financial adviser to school districts across the state. "The challenge is that the market has repriced to significantly higher interest rates."

California Treasurer Bill Lockyer had to work hard to lure investors to the deal after reducing the size of the offering from $7 billion. After Gov. Arnold Schwarzenegger failed to secure federal aid in placing the debt, the former action movie star hit the airwaves in commercials touting the notes.

Lockyer's office reported that retail demand was strong enough to increase the size of the Ran offering to $5 billion from $4 billion. The state reduced the yields offered on $1.2 billion of notes that mature May 20, 2009, to 3.75%, the low end of the 3.75% to 4% range the state initially offered. It also cut the yield on $3.8 billion of notes that mature June 22, 2009, to 4.25%, the low end of a 4.25% to 4.5% range, as it took retail orders for 78% of the notes.

That's not cheap. It's about four times the one-year Treasury rate, and it's higher than the The Bond Buyer one-year note index, which rose 30 basis points this week to 2.69%. The yield to par call on The Bond Buyer 40 rose above 8% this week, up from 4.6% a year ago, when the benchmark federal funds rate was 375 basis points higher.

The question for local governments and their advisers is whether these rates are an aberration or a new status quo. The answer to that question will decide the fate of many of the deals that have been pulled or delayed in recent weeks. Market participants are divided on the answer.

Brentwood finance director Pamela Ehler had planned to sell $56.6 million of revenue bonds through the Brentwood Infrastructure Finance Authority in mid-September. As Lehman Brothers and the credit markets collapsed last month, she delayed her deal.

"We're going to wait for six months and see how the market looks because of the interest rates and volatility in the market," she said. "We have a year to finance this, so there's no rush."

Ehler is currently using commercial paper to finance the debt via another agency. She has to take the paper out in the next year, but doesn't want to lock in today's long-term rates for the next 30 years if she doesn't have to. In the meantime, Brentwood is paying about 3% on the debt, up from 1.5% before the current round of the financial crisis.

Anthony Taddey, a managing director at RBC Capital Markets in Los Angeles, sees signs of thawing in the market with the most recent round of multinational government interventions to right the banking sector. Weekly variable-rate demand obligations are resetting back in the 2% range this week after jumping to above 8% last month after Lehman's bankruptcy.

"I'm optimistic. I would like to think that the worst is behind us," Taddey said. "There's been a tremendous global response" to the credit crisis.

The California Ran issue "seems to be going very well," said Taddey, whose firm is part of the syndicate on the deal. "That's going to clear the market and set some trading levels. We haven't had a benchmark deal on the short end in quite a while."

He predicted that the market will have a long, slow return to "more normalized liquidity levels" over the next year or so, freeing up capital for muni deals.

"If you absolutely need the money within the next three to six months, you'd probably be well served to get the deal done," Taddey said. "The market could very well be no better or worse in the next three to six months."

But he does see room for improvement in the longer term and has counseled some clients to be patient.

"If you don't really need the money for six to 12 months, we feel the market may be more conducive at that time," he said.

Small of Capital Public Finance disagrees. "There's no reason to wait," he said.

He and his clients debated the issue last month as he helped the Santee School District in Southern California sell a $23 million certificate of participation deal in the days after Lehman's bankruptcy. The district chose an underwriter with a good retail client base and sold the deal in the midst of the most turbulent market in memory. They priced the 40-year capital appreciation bonds at about 5.7%. That seemed like a high rate at the time, but the school district had construction contracts that had to be paid.

"That was the week that everybody was waiting for Congress to approve the housing rescue plan" and issuers across the nation were debating pulling deals until federal lawmakers acted to solve the economic crisis, Small said. "We decided to go forward because we had a deal that was within our financing parameters and our legal authorization."

He said the weeks since have proven that waiting for better market conditions is a losing game in this market.

"Nobody is a market timer," Small said. "If we had waited, we'd have probably paid more than 7%."

To him, that means issuers who need capital and see an opportunity to raise it should take it.

"It may not be a stable market. Rates have moved higher," Small said. "But it's not like you can wait for a better day next week."
